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PENSIONS & October 16, 1989

InvestmentAge

THE NEWSPAPER OF CORPORATE AND INSTITUTIONAL INVESTING $6 AN ISSUE • $110 A YEAR

Top 20 institutional holders of ADRs
(U.S. $ millions)

July 1988	Amount	November 1988	Amount
CIGNA	960	FMR	596
Delaware Mgmt.	738	Manufacturers Nat'l	413
FMR	522	Wells Fargo Bank	405
Manufacturers Nat'l	501	CREF	398
Capital Guardian	413	Wellington	396
Wellington	386	Delaware Mgmt.	384
California Public Employees	369	Mellon Bank	377
INVESCO Capital Mgmt.	239	J.P. Morgan	364
Alliance Capital Mgmt.	232	IDS Financial	338
IDS Financial	227	Capital Guardian	333
American Capital Mgmt.	206	First RepublicanBank	327
Lazard Freres	198	Bankers Trust	269
J.P. Morgan	198	Newbold's Asset Mgmt.	251
Scudder, Stevens & Clark	197	Alliance Capital Mgmt.	247
Dreman Value Mgmt.	182	INVESCO Capital Mgmt.	239
Merrill Lynch Asset Mgmt.	181	Merrill Lynch Asset Mgmt.	237
Templeton	169	Citicorp	228
Pioneering Mgmt.	167	Minnesota State	202
Newbold's Asset Mgmt.	143	Lazard Freres	190
Rosenberg Institutional	143	NY State Teachers	189

Source: Carter Vallin Pollon, New York

Fund jumps on indexing

California Employees put 85% of stocks into passive strategy

By Steve Hemmerick

SACRAMENTO, Calif. — The $54 billion California Public Employees' Retirement System is indexing about $17 billion of its $20 billion in domestic equity assets, prompted by fears that underperforming the equity market by even one percentage point could mean an opportunity loss of hundreds of millions of dollars.

The remaining $3 billion in equities will remain with external active managers.

The index funds will be run in-house, using money that also had been internally managed, but in computer-driven active and passive strategies.

DeWitt Bowman, chief investment officer, said the fund is "well along" in the transition to indexing, which began in August.

About 70% of the passive assets will be indexed to the Standard & Poor's 500 Stock Index; the other 30% will be indexed to stocks outside the S&P 500 that are included in the Wilshire 2500 Stock Index.

In indexing, the pension fund is following a trend that has been continuing throughout the 1980s, particularly for very large pension funds, said Stephen Nesbitt, senior vice president and head of the pension consulting group at Wilshire Associates, Los Angeles. Mr. Nesbitt didn't think the trend had slowed.

Mr. Bowman wouldn't give a specific figure for the amount indexed since August because trading into the appropriate stocks is still ongoing and any public comment on the fund's market moves could affect prices for stocks and mean unnecessary losses for the equity portfolio, he said.

He said fund officials had considered the effect their indexing would have on the market, and concluded it will not move the market in either direction. But at some distant point in the future, if funds continue to index, indexing will become "dysfunctional" in that smaller investors will have disproportionate effects on market prices.

The retirement fund's move into equity indexing is one of the largest such moves for a single fund, said Lisa Shultz, a research analyst with Frank Russell Co., Tacoma, Wash.

Mr. Bowman said the decision to move into index funds began in the late summer or fall of 1988 following the decision of Greta Marshall, the former chief investment officer, not to seek a renewal of her three-year contract.

The fund had been getting a market return using an in-house, computer-driven, half-active/half-passive equity investment system, but Ms. Marshall, the architect of that system, left in June 1988. California fund officials had doubts about being able to guarantee future market returns using the system designed by her.

DeWitt Bowman said the California fund is "well along" toward indexing $17 billion.

During her years at the helm, Ms. Marshall had moved the fund from more traditional in-house stock investing to a quantitative investment method that selected stocks on a capitalization basis, said Ms. Marshall.

The stocks were further subdivided into growth stocks and value stocks and split again between active and passive strategies. In all, there were 12 pools of stocks: six actively managed and six passively managed.

In the active pools, weightings were shifted based on forecasts of market segments that were to get the highest returns.

Ms. Marshall's intention was to find whether active or passive strategies were superior. At the time, she said if active strategies didn't outperform passive strategies, the entire domestic equity portfolio,

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ADR use increases in U.S. acquisitions

By Fred Williams

American depository receipts could become the financing vehicle of choice for foreign firms that want to acquire U.S. companies, allowing them to conserve cash and avoid exhausting their borrowing capacity.

Although only about 25 acquisitions by foreign companies of U.S. firms have involved ADRs, the increased use of ADRs to finance acquisitions through an exchange of stock or a direct purchase using a combination of cash and securities appears to be growing.

The latest example of ADR financing came in late September when the Kyocera Corp. of Japan and AVX Corp., Great Neck, N.Y., announced a merger worth about $531 million. The merger involved an exchange of all outstanding shares of AVX for Kyocera ADRs, which represent two shares of Kyocera stock.

Kyocera is a ceramics manufacturer in Kyoto. AVX manufactures ceramics and glass capacitors used in electronic systems.

The growth spurt is due partly to the fact market conditions are beginning to favor such transactions, according to Philip Keevil, managing director and head of merger and acquisition activity at the

Continued on page 67

Panel proposes way to pay retiree health liabilities

By Joel Chernoff

WASHINGTON — The Senate Finance Committee boosted employers' ability to pay for their retiree-health liabilities, but Congress might increase those liabilities substantially.

The good news is that the Senate Finance Committee's budget-reconciliation bill, which was approved Oct. 4, would make it easier than other congressional proposals to transfer surplus pension assets to retiree health accounts.

The Senate bill — unlike its House Ways and Means Committee counterpart — does not require employers to purchase annuities for pension benefits before allowing the transfer. Employers insisted the annuitization rule made the provision expensive and unworkable.

The bad news is that pending efforts curb Medicare catastrophic coverage would increase employer liabilities for retiree health benefits — by as much as $30 billion.

Meanwhile, congressional panels have been vying over other pension-related issues *(see related story on page 70)*. They include:

- Replacing controversial user fees for filing pension reports with an increase to $18 per participant from $16 in the premium paid to the Pension Benefit Guaranty Corp. as well as increasing various penalties;
- Changing the full-funding limitations to aid firms with younger work forces;
- Adding a new portability provision; and
- Redefining employers'

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Implications of bank contracts merit some close looks - 55

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LATE NEWS

Loomis, Sayles to spin off unit

BOSTON — Loomis, Sayles & Co. Inc. is spinning off the Capital Growth Management Division, an aggressive equity manager, to be owned jointly by Loomis, Sayles principals Kenneth Heebner and Robert Kemp and by The New England.

The New England owns 66% of Loomis. Mr. Kemp has been president and chief executive officer of Loomis, Sayles for the past 12 years; Mr. Heebner directs the Capital Growth Management division. The two men will serve as co-general partners, and initially will purchase a 25% equity stake "and work our way up from there," Mr. Kemp said. The New England will own the remainder. The new company will manage the $2.2 billion in assets now managed by Mr. Heebner.

Executives form new Texas firm

DALLAS — Four of the five investment professionals of MSecurities Corp. have resigned to set up their own investment management firm following the sudden announcement by Dallas-based MCorp. that it would sell MTrust, its trust and investment subsidiaries, to Ameritrust Corp., Cleveland.

Hilton Hemphill, chief investment officer; Keith McClendon and Ron Trout, both senior vice presidents and portfolio manager-analysts; and Linda Calkin, analyst, resigned from MSecurities effective Oct. 31. The four will form Hourglass Capital Management, which be located in Dallas.

Ameritrust said it agreed to acquire MTrust — of which MSecurities is a part — for $120 million, of which $105 million will be cash and $15 million in a note maturing in five years. According to Ameritrust, the addition of MCorp.'s $17 billion in trust and custody assets will create operations with $48 billion in trust and custody assets.

Performance fees to be offered

NEW YORK — Alliance Capital Management L.P. received permission from the Department of Labor to offer pension fund clients an option to pay on a performance-based fee basis, using as a benchmark a normal or customized portfolio.

The department issued the permission Oct. 11. David H. Williams, Alliance chairman and chief executive officer, said he had no time to comment and declined to make other executives available.

Under the Labor Department permission, Alliance and its clients would negotiate the type of benchmark to be used. Alliance proposes it may be a standard benchmark, or a normal portfolio. Alliance would construct a normal portfolio using criteria prepared by BARRA, a Berkeley, Calif., consultant.

Clients would pay Alliance under one of three performance fee arrangements. Alliance would offer the performance-based fee option to clients with at least $50 million in total assets.

The Labor Department approval didn't specify if the permission was granted solely for equities, or also includes fixed income.

Sandy Lincoln joining Kemper

CHICAGO — Sandy Lincoln, former managing director of the asset planning practice at William M. Mercer Meidinger Hansen Inc., will join Kemper Asset Management Co. as president Oct. 30.

Mr. Lincoln replaces Leonard Spalding, who left Kemper Asset Management to become president of a newly formed securities subsidiary of Chase Manhattan Bank, New York.

Kemper Asset Management, a subsidiary of Kemper Financial Services Inc., Chicago, has $2.4 billion under management.

Committee OKs Ball nomination

WASHINGTON — The Senate Labor and Human Resources Committee has approved the long-delayed nomination of David George Ball to be assistant secretary of the Department of Labor's Pension and Welfare Benefits Administration.

Mr. Ball has served in several executive positions at AMAX Inc., Greenwich, Conn., most recently as senior executive adviser.

The nomination is subject to full Senate approval.

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Questionnaires have been sent

Questionnaires are in the mail for *Pensions & Investment Age*'s annual directory of the 1,000 largest pension funds. In order to be included in the Jan. 22 directory, pension fund executives must return the questionnaires by Nov. 10. If you have any questions, please contact Christine Philip, directory coordinator, at (312) 649-5217.

Market repays investors

But some pension funds cut stocks, miss out

By Leonard J. Hollie and Terry Williams

As the second anniversary of the 1987 stock market crash approaches, pension funds that steadfastly maintained their equity allocations have reaped the rewards.

The stock market recovery that has carried the Dow Jones Industrial Average to record highs has more than recouped the losses those funds incurred during the crash.

The stock portfolio of the American Telephone & Telegraph Co. pension fund, New York, for example, has $1 billion more now than it had just before the crash, excluding new contributions.

"There is a sigh of relief," said James Heller, district manager-U.S. stock and bond manager policy for the $33.5 billion AT&T fund. "It confirms our strategy of holding firm and taking the long view. Because of our size, it doesn't play to our strength to make short-term changes in our asset mixes."

On Sept. 30, 1987, more than two weeks before the market crash, AT&T had an equity allocation of 55% of assets, or $17 billion. By year end, as result of the market plunge in October, the equity allocation had dropped to 49% of assets, creating a $4 billion paper loss. But by Aug. 31 of this year, AT&T's equity allocation had rebounded to 52.5%.

"We feel that all of the capital markets are highly efficient, and it would be useless for us to second-guess all of the collective thinking that has shaped those markets," Mr. Heller said.

Other pension funds, however, reduced their equity commitments following the crash, and didn't participate fully in the stock market recovery.

According to Trust Universe Comparison Service data gathered by Wilshire Associates, Santa Monica, Calif., the median equity position of the 200 funds in the universe as of June 30 was 48.5%, down from 50.2% on Dec. 31, 1987, immediately after the market crash. The equity allocation had been as high as 55.4% as of June 30, 1987.

In fact, according to TUCS data, pension funds and/or their managers reduced their equity positions in the third quarter of 1987, just before the crash, by $14 billion. They continued to reduce equity commitments by $13 billion in the first quarter of 1988, $8 billion in the second quarter and another $19 billion in the next three quarters combined.

Dale Stevens and George Wolfe, vice presidents with Wilshire, attribute the decrease in equity allocations to pension fund managers' desire to reduce their equity exposure once the market began to recover in the first quarter of 1988.

The pension fund officer is not going to allow a run up in the market to increase his exposure to equities, Messrs. Wolfe and Stevens surmised.

During the bull market preceding the crash, there was a pattern of net flow of assets out of equities.

The only quarter in which pension fund managers didn't draw

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International, GICs big draws

Active management favored over passive

By Trudy Ring

International diversification and managed guaranteed investment contracts were key strategies in attracting business in the third quarter.

Among manager hirings reported in *Pensions & Investment Age*, international and global strategies attracted $550 million in the quarter, with $320 million going to equities and $230 million going to bonds. Of the equity assets, $66 million was for index funds.

By comparison, domestic equities and bonds, a much larger part of tax-exempt portfolios, attracted not that much more than international. A total of $537.5 million went to domestic equities, of which $133 million was indexed, and $269 million to bonds, of which $35 million was indexed.

These figures are limited to hirings reported in *P&I Age*; managers may have attracted other accounts that were not publicized.

Many of the international hirings were by large public pension funds, which are catching up to their corporate counterparts in this area. These funds included the $7 billion State of Connecticut Trust Funds, Hartford; the $3 billion Illinois State Board of Investment, Chicago; the $1.3 billion District of Columbia Retirement Board; and the $400 million North Dakota Teachers' Retirement System, Bismarck.

The international trend indicated by these hirings is consistent with the observations of InterSec Research Corp., Stamford, Conn.

Net funding of international and global managers reached the same level — $4.5 billion — in the first half of 1989 as it did in all of 1988, said Duncan Fordyce, senior vice president and partner of In-

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Most new accounts* 3rd quarter 1989

Firm	New accounts
First Chicago Investment	6
Northern Trust Co.	6
IDS Trust	4
Sovran Capital Mgmt.	4
Eagle Asset Mgmt.	3
State Street Bank	3

* As reported in *Pensions & Investment Age*

Most new assets* 3rd quarter 1989

Firm	$ mils.
Trust Advisory Group	450
T. Rowe Price	300
First Chicago Investment	140
Bankers Trust	126
Weiss, Peck & Greer	108
State Street Bank	106

* As reported in *Pensions & Investment Age*

Florida may limit consultants

By Hillary Durgin

TALLAHASSEE, Fla. — Actuaries and bar associations across the country are squaring off in response to an advisory opinion drafted by The Florida Bar Association that would permit only lawyers to conduct employee benefits practices.

The opinion was filed with the Supreme Court of Florida in an effort to clarify whether persons without a law license engage in the unlicensed practice of law when drafting a pension plan. The issue first surfaced in the 1978 case Florida Bar vs. Turner.

The opinion would prohibit actuaries, benefits consultants and accountants not working for a law firm from advising on employee benefits issues. Only attorneys would be authorized to perform many of the services associated with the design and drafting of pension plans in the state.

While the current case is restricted to Florida, "there's definitely a consideration that it might affect other states," said Mary Ellen Bateman, counsel for the unlicensed practice of law committee for the Florida Bar Association. The committee drafted the opinion.

Some 22 briefs were filed in response to the Florida Bar's opinion by the Oct. 2 deadline, according to Ms. Bateman. The Florida Bar has until Nov. 27 to respond. The case is not expected to be heard until next year.

The opinion, filed July 28, defines as unauthorized many of the services that non-legal professionals perform in employee benefits consulting. Under the opinion, anyone other than a lawyer would be prohibited from advising clients on plan design and drafting plan documents, including summary plan descriptions. They also would be restricted from providing advice on such

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Tactical asset allocation use slows

Some firms miss out on bull market

By Hillary Durgin

The move by many institutional investors and money managers to tactical asset allocation following the stock market crash two years ago is slowing.

In addition, many tactical asset allocators in early 1989 shifted their assets out of stocks and into cash equivalents in anticipation of a recession, causing them to miss much of the growth in the stock market.

The 21 managers offering a tactical asset allocation product surveyed by *Pensions & Investment Age* reported $56.979 billion under management in the strategy, up 29.5% from last year's total of $44.01 billion.

(All figures, unless otherwise noted, are as of Aug. 31).

The growth of assets invested in TAA products, however, has not matched the heady pace of 1988. Last year, a *P&I Age* survey found 15 managers with $38.374 billion in tactical asset allocation accounts as of Aug. 31, 1988, an increase of 41% from the previous year.

Interest in tactical asset allocation might have ebbed even further, as the growth figures are not adjusted for market appreciation. There was, for example, a slowdown in the number of new clients added by TAA managers. The 21 firms surveyed this year picked up 127 clients during the year ended Aug. 31, compared with 138 clients added by the 15 firms in the 1988 survey.

Tactical asset allocation uses quantitative strategies to make short-term switches among asset classes — traditionally stocks, bonds and cash equivalents. Lately new classes, including real estate and metals, have been added.

Managers said there is more interest in global tactical asset allocation, mirroring the burgeoning move to global investing across all asset classes.

"Right now the interest is very definitely in global," said Denis Karnosky, managing director and head of asset allocation at Brinson Partners Inc. (formerly First Chicago Investment Advisors), Chicago. "That is where by far the most growth has been," he said.

Assets invested in TAA products at Brinson Partners grew 25% to $6 billion during the 12 months ended Aug. 31. The firm added 14 clients during this period, bringing the total number of TAA accounts to 76.

TSA Capital Management, Los Angeles, began offering a global tactical asset allocation at the end of the third quarter that invests in U.S., Japanese and U.K. securities. Under the strategy, the firm shifts among stocks, bonds and cash equivalents, said Roger Clarke, chief investment officer and managing director. "Firms have been moving more assets internationally," he said. "It's a natural extension of TAA."

TSA had $3.514 billion in tactical asset allocation accounts as of Sept. 30, up 5.7% from the previous year. The firm has 32 TAA clients, compared with 30 last year.

Other managers reported a growing interest in global TAA strategies that, for the most part, has not translated into a commitment of assets.

"There's a certain skepticism at the moment," said Patricia Dunn, president of Wells Fargo Investment Advisors, San Francisco. "I think that most of the (TAA managers) have been out of the market or not fully exposed to stocks for the past six to eight months."

Wells Fargo is the largest tactical asset allocation manager, with $11.614 billion under management, up 27.8%.

The firm added nine clients during the year ended Aug. 31, bringing its total to 116. Ms. Dunn declined to discuss Wells Fargo's asset allocation strategies.

One TAA manager who stayed in stocks this year was Matrix Capital Management, Greenwich, Conn.

"We've been pretty much straight up in the stock market, and most tactical asset allocation managers missed that," said Michael Petrino, president of Matrix, which has $251 million under management in TAA products, an increase of 37.9% from the previous year. The firm's client base held steady at six.

Mr. Petrino, who said he has used TAA strategies for 10 years, said the firm had been close to the client equity targets and had anticipated the bull market. He said about $48 million, or 70%, of the $68.4 million increase in assets was the result of market appreciation.

Many managers have been reacting with caution to current market conditions and have been varying their asset allocation accordingly during the past six months.

"Tactical asset allocation is a capital preservation strategy," said Bruce L. Poliquin, vice president and director of client services at Avatar Associates, New York. "In bull markets, sponsors have to be cautious."

The firm allocates assets based on liquidity, or the degree of money flow in the economy. In the past month, Avatar has been moving out of stocks in response to what the firm perceives to be a tightening of the credit environment and a contraction of liquidity.

"We react to that by decreasing our commitment to stocks and bonds in our portfolio," Mr. Poliquin explained. Avatar gradually decreased its allocation to 65% stocks and 35% cash from 90% stocks and 10% cash. An alternate strategy invests 55% of assets in

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Managers with tactical asset allocation accounts ($ mils. as of Aug. 31)

Firm	1989	1988
Wells Fargo	11,614	9,087
Prudential	7,200	6,600
Mellon	7,100	5,500
Brinson Partners	6,000	4,800
First Quadrant	4,000	1,800
TSA*	3,514	3,325
Boston Co.	3,000	2,100
J.H. Ayres	2,200	2,000
J.P. Morgan	2,148	577
Avatar	1,800	1,300
Bankers Trust	1,800	1,700
Renaissance	1,790	1,578
Chancellor	1,700	1,176
Beacon	1,000	800
Webster	1,000	900
Chase Investors	410	310
Matrix	251	182
Baillard, Biehl	250	200
Davis, Weaver	100	0
Oxford	92	75
Schield	10	0
TOTAL	56,979	44,010

*Data as of Sept. 30

European buyers waste little time

By Margaret Price

SHEFFIELD, England — A new European buy-in fund, whose investors include eight U.S. pension funds, made its first acquisition before the fund's second closing officially occurred.

Officials of the MMG Patricof Group of London and Paris said a shell company owned by its new MMG Patricof European Buy-In Fund has reached an agreement to purchase James Neill Holdings PLC for approximately $124.8 million.

James Neill Holdings, Sheffield, England, manufactures hand and garden tools, industrial saws, measuring tools and other implements.

This purchase represents the first of what is expected to be six acquisitions — three in the United Kingdom and three in France over the next three years — by the approximately $324 million buy-in fund. The James Neill Holdings deal initially was all cash with no borrowing. The fund intends to refinance the transaction with some portion of debt as part of the package, said Alan Patricof, chairman of the U.S. operation of MMG Patricof.

The Patricof fund, which is denominated in European Currency Units, was expected to close formally late last week. The first closing was in March.

According to its managers, the buy-in fund is oversubscribed and has attracted 17 institutional investors from the United States and United Kingdom.

U.S. investors include the approximately $9 billion Common Fund, Fairfield, Conn., and the $2.9 billion Massachusetts Pension Reserves Investment Management Board, Boston. Each fund invested about $20 million.

Other U.S. investors are the pension funds of Union Carbide Corp., Danbury Conn.; Textron Inc., Providence, R.I.; Eastman Kodak Co., Rochester, N.Y.; IBM Corp., Stamford, Conn.; General Motors Corp., New York; and American Telephone & Telegraph Co., New York. Amounts invested by these plans were not revealed.

The MMG Patricof fund is designed to take a majority interest in companies with sales in the $160 million to $320 million range. As part of the deal, the fund would bring in its own management team to supplement management in the acquired company. Plans are to hold the companiei61for about five years.

The fund specifically seeks low-technology companies with leadership positions in their industries but whose profitability has faltered. All deals would be on a friendly basis.

"The fund is unique in two ways," said Ronald Cohen, chairman of MMG Patricof. "The fund concentrates solely in buy-ins, meaning that we are bringing management to companies as well as investing in them. And it's also the only fund in Europe that brings its partners into the company instead of managers who haven't previously been affiliated with the fund."

Supplemental mezzanine and senior debt will help finance individual transactions. But after the acquisition, companies should average only a 2-1 debt-to-equity ratio, com-

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Lowry out for new game

Consultant marketing again after substantial changes

By Barry B. Burr

ATLANTA — Lowry Consulting Group Inc. plans to begin its first marketing effort as a new and revamped unit of USF&G Financial Services Corp. after the loss of several pension clients and principals who provided ideas and brought in existing business.

It isn't clear if the clients left because of USF&G's acquisition, which ended the independent ownership of the firm — formerly named Lowry, Raclin, Harrell & Howerdd — or because of some doubts about the value of the consulting firm's disciplined asset allocation methodology, based on price-to-book ratio, according to interviews with executives of current and former pension fund clients and others.

Before USF&G's acquisition, which was completed earlier this year, Lowry was one of the few major consultants offering only consulting services without ties to brokerage or money management services.

In the last year, Lowry has lost 10 corporate pension fund clients, according to its own reports.

American Cyanamid Co., Wayne, N.J., pulled its $1 billion pension fund from Lowry, although it left a subsidiary's $100 million pension fund, said Daniel Susik, manager-financial analysis and investments. He declined to identify the unit or elaborate on the change. Mr. Susik said American Cyanamid hasn't hired a consultant for the $1 billion fund.

Associated Milk Producers Inc., San Antonio, Texas, dropped Lowry for its $130 million pension fund to move to Harrell, Cooper Associates Inc., a Dallas consulting firm founded by Robert L. Harrell, a former shareholder in Lowry who left in 1988 after USF&G acquired a 40% stake.

"We were concerned with the possibility of conflict of interests, especially where they had responsibility for recommending managers and they have (money) management firms of their own," said Harry Pickens, controller.

USF&G owns Axe-Houghton Management Inc., Tarrytown, N.Y., which manages nearly $900 million in tax-exempt assets, and Chancellor Capital Management, New York, which runs $13 billion in tax-exempt assets.

Mr. Pickens said no such conflicts had arisen. He said the fund preferred to stay with Mr. Harrell, its long-time consultant.

Campbell Soup Co., Camden, N.J., dropped Lowry last year "due to a decision to find a better consultant" for its $600 million pension fund, said Douglas H. Springer, vice president-investment management. He declined to elaborate.

Campbell hired Strategic Investment Management, Washington.

Barnes Hospital, St. Louis, dropped Lowry earlier this year for its $60 million pension fund and $185 million endowment, said Robert L. Mueller, assistant treasurer.

"That was a decision made not due to any of the ownership changes," he said.

"They're a fine firm. We had good results from them. They helped us a great deal in getting us out of the (stock) market in 1987 on a timely basis" under the Lowry asset allocation model.

But since then, Barnes has kept a large part of both funds in fixed income. Mr. Mueller said Barnes executives believe Lowry isn't as comprehensive in consulting on fixed income. "We thought we could get better advice at a lower price," he said.

Earlier this year, Barnes replaced Lowry with DeMarche Associates, Kansas City, Mo.

The $32 million pension fund of the Mid-America Dairymen Inc., Springfield, Mo., dropped Lowry in the beginning of the year. It

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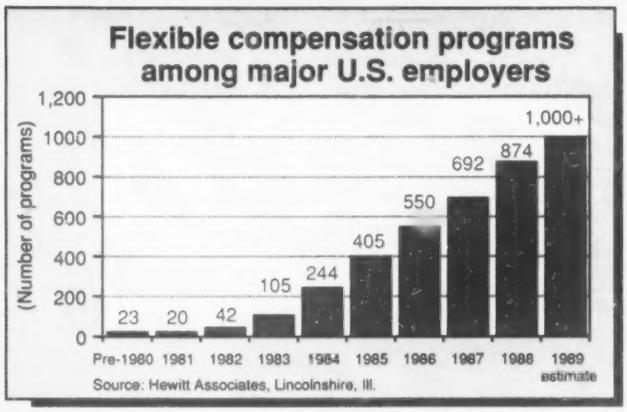
Since USF&G's acquisition of Lowry Consulting Group, William Lowry, left, is an adviser and has no direct involvement with the firm; Michael Wilkinson, right, now is president and CEO.

EMPLOYEE BENEFITS



Coming on strong

Flexible spending programs flourish

By Hillary Durgin

Employers who were distressed in March over proposed tax changes for health care flexible spending accounts, now are modifying their plans and embracing flexible benefit programs wholeheartedly.

The new regulations, scheduled to take effect Jan. 1, will expose employers to some financial risk by requiring them to provide full medical coverage to employees throughout the year.

Employers have realized that the risk isn't as great as they first thought.

"There was some thought that the regulations would wipe out" flexible spending accounts, said Tom Butterworth, a legal consultant with Hewitt Associates, Lincolnshire, Ill. "That hasn't been the case."

He said employers "are not abandoning plans, and new companies are embracing flexible benefits without getting bogged down with the regulations."

In a flexible spending account, an employer contributes to an account for each employee for the reimbursement of health care expenses. In some plans, employees also contribute through salary reduction plans. The amount in the account is used to pay for hospitals; doctors, dentists and psychiatrists; prescription drugs; and vision care.

Flexible spending accounts operate in three ways:

- **Accrual**: An employee builds up an account balance during the year that is used to pay bills as they occur. If the account balance is too small to pay an entire bill, only part is paid.
- **Advance payment:** The employer pays to the employee whatever level of coverage has been agreed upon. At the end of the year, the employee submits the bills he or she has paid. Any unused amount is reported as taxable income.
- **Uniform coverage:** The employee gets full coverage throughout the plan year. Bills are reimbursed as they are submitted, no matter how much the employee has "contributed" to the account at that point.

Under the new regulations, only the uniform coverage approach will be allowed. Thus, employers would be required to provide full coverage throughout the year, even if the employee does not have the money in his or her account.

The danger is that if an employee leaves a company early in the year, after having incurred major medical expenses without having the necessary money in his or her account, the company must absorb the expense.

Yet despite the proposed changes, most employers are holding on to their plans, and

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Cash balance plans a hit

'Unorthodox idea' embraced by more and more employers

By Diane Hal Gropper

Despite early criticisms, cash balance plans have caught on with some of the largest corporations in the country.

Since Bank of America became the first major employer to adopt a cash balance plan in July 1985, many others have followed, including: Borden Inc., Colgate-Palmolive Co., RJR Nabisco Inc., Xerox Corp., General Signal Corp., BP America, Chase Manhattan Bank, Georgia-Pacific Corp., C&S Corp., Sun Co., Cooper Industries Inc., Continental Can Inc. and Equitable Life Assurance Society of the United States.

Judging from the number of cash balance plans benefit consulting firms say they have set up, it appears that close to 100 companies have made the switch from a defined benefit plan — not bad for an unorthodox new idea.

When the cash balance plan made its debut a few years ago, it didn't exactly get rave reviews.

Everyone agreed it was a clever way to make a defined benefit plan look like a defined contribution plan; the benefit promise was expressed not as a function of far-off final pay but as an account balance that vests quickly and steadily grows over time in line with pay and guaranteed interest credit. Between that and the larger benefits the cash balance plan delivered to short-service workers, it was clear the new hybrid would be a hit with most employees.

Still, it was criticized as a trendy idea that ran contrary to corporate America's long-standing preference to reward long-term service. Detractors predicted it would never make much headway, no matter how hard Kwasha Lipton — the benefits consulting firm that introduced it — promoted the idea.

No one is more gratified to see the progress than Lawrence Brennan, the Kwasha partner who created the cash balance plan. He's not surprised it's winning converts because he firmly believes it offers tremendous advantages over the traditional defined benefit plan. Even Kwasha itself has one of the plans.

But its growing acceptance also pleases him because it silenced the criticism, which primarily came from fellow benefit consultants. The success, he said, "makes up for the comments we got from other practitioners at the time."

Lawrence Brennan is pleased with the success of his cash balance plan creation.

Today all benefit consulting firms include a cash balance type of hybrid in their plan design arsenals, and a few have even taken to marketing it under their own brand names. TPF&C calls it the pension equivalent reserve credit product, or PERC; Martin E. Segal Co. has a similar product called the minimum balance plan.

The plan has gotten a boost from an unexpected source — the Tax Reform Act of 1986. Tax reform has necessitated extensive pension plan redesign thanks to the new vesting, coverage and integration rules it mandated, all of which took effect this year.

Many companies figured that "if they have to do everything over anyway, they might as well sit down and consider other plan designs," said Marvin Green, practice leader for qualified plans at TPF&C.

Growing numbers of employers are deciding to convert to cash balance plans because they better meet the needs of today's work force. Defined benefit plans skew pension payments toward long-service workers by accruing benefits on an age-related basis, which means older employees earn them at a faster rate than young employees. But most workers don't spend their entire careers at one company, and many change jobs so frequently they never vest in a pension plan. Even if they do stay long enough to vest, their benefits are frozen at departure and are corroded by inflation over time.

The cash balance plan in its classic form accrues benefits at an equal pace regardless of a worker's age; all workers get the same percentage of pay — typically 4% to 6% annually — credited to their accounts. This redistributes benefits from older to younger employees, who can take their bigger slice of the pension pie with them when they leave because participants vest quickly (five years was the norm even before tax reform) and the plans offer portable benefits.

Philosophically, not all companies feel comfortable with that kind of benefit redistribution.

The businesses that take best to the cash balance plan are those that don't expect most of their employees to stay until retirement, said Donald Hasbargen, a partner at Hewitt Associates, Lincolnshire, Ill.

Work force issues were a major factor in Equitable's decision to switch to a cash balance plan; it took effect this year. Robert Sjogren, vice president for employee benefit design and administration, said his company feels it is a "fairer approach" because its own analyses have shown that 90% of Equitable's employees less than 40 years old won't stay until retirement.

"We also know there will be a shortage of skilled labor in the 1990s and the next century, and we think this plan will make us more competitive in the labor market," Mr. Sjogren said.

Some companies like the basic cash balance idea but don't want

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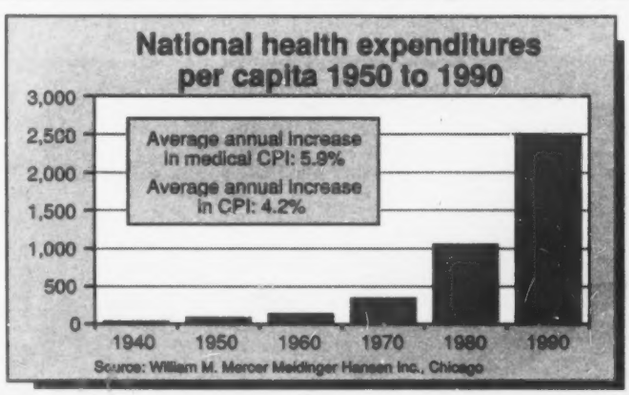
Health care a hot topic for the '90s

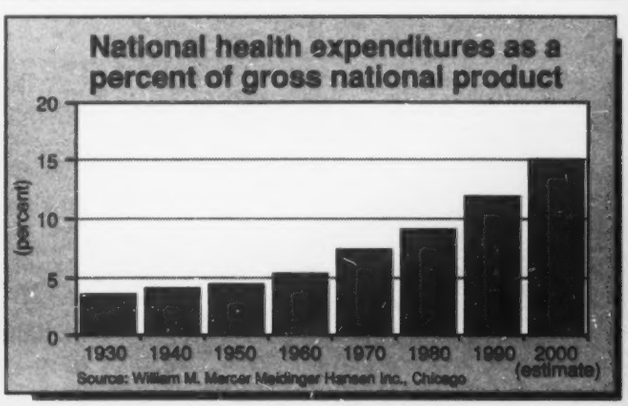
By Fred Williams

Health care issues likely will replace pension issues as the primary employee benefits topic of the next decade.

The reasons:

- Health care costs are rising dramatically for both active and retired employees.
- The ratio of active employees to retired workers is declining.
- Massive unfunded liabilities for retiree medical care have been building up, complicated by the proposal by the Financial Accounting Standards Board to replace pay-as-you-go accounting with accrual accounting for future retirees' health benefits.





If the FASB proposal is adopted, "it would translate to significant reductions in net income, probable reductions in tangible net worth and possible reductions in shareholders' equity. . . . The related annual expense for the typical employer will quadruple and the debt/equity ratio of many companies will be affected significantly and, in some cases, dramatically," David M. Walker said at a recent gathering of pension executives. Mr. Walker is partner and national director-compensation and benefits practice for Arthur Andersen & Co. and former assistant secretary of labor for pension and welfare benefit programs.

Adds a report from the consulting firm of TPF&C, New York, "the top 100 industrial companies in the aggregate could experience a 25% reduction in profits, for a total of $17 billion" if the FASB exposure draft is adopted.

The furor over the impending FASB proposal has caused many

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Programs flourish

Continued from page 17

making few or no modifications.

According to a survey conducted by A. Foster Higgins, a Princeton, N.J.-based management consulting firm, of 253 companies that offer flexible spending accounts, 47% will leave their plans alone. Another 33% will continue to use flexible spending accounts but will reduce the maximum amount employees can contribute to the accounts. The remaining 20% said they will eliminate their plans because of the regulations.

"Employers' comfort level in being able to administer a flex plan that employees will accept far outweighs their fear that Congress is going to derail the whole idea," said Michael Taggart, principal at William M. Mercer-Meidinger-Hansen Inc., New York.

A flexible benefit plan is a program under Section 125 of the Internal Revenue Code that offers employees the choice between taxable benefits (including cash) and non-taxable benefits such as health and life insurance, vacation pay, retirement plans and child care. The employee decides how his or her benefit dollars are to be allocated for each type of benefit from the total amount promised by the employer.

Flexible benefit plans, also called cafeteria plans, have become increasingly popular as employers search for ways to boost employee recruitment and retention while containing costs.

More employers implemented flexible compensation plans in 1988 than in any other year in the past decade, according to a January 1989 survey by Hewitt Associates. Some 250 programs were added, bringing the total to 942, up 36% from last year's total of 692.

Many employers say flexible benefits programs provide advantages that outweigh the potential risk posed by the new Internal Revenue Service regulations. Plus, under "use it or lose it" rules, employers automatically get the money remaining in employees' flexible spending accounts at the end of the year.

"The forfeitures will probably more than offset any of the abuses that might occur," said Dennis Habrat, director of compensation benefits at Brush Wellman Inc., Cleveland. The manufacturing company's plan, introduced in January 1988, covers all 2,500 employees.

Brush Wellman does not plan to modify its FSA account in response to the new regulations, Mr. Habrat said. While employees are allowed to save up to $5,000, they save on average "something less" than $1,500 to $2,000, he said.

"Between the forfeitures savings and the FICA tax saving, those two elements are almost double what the projected loss is for the employers under the new regulations," said George Faulkner, a managing consultant at Foster Higgins.

As a precautionary measure, many employers are reducing the maximum that employees can contribute to the flexible spending account. At Chemical Bank, New York, the ceiling will be lowered to $2,000 from $5,000, said Mark J. Schneiderman, senior vice president in charge of human resources.

Chemical, which introduced its plan earlier this year, has 17,000 employees enrolled. Next year, close to 30,000 will be enrolled, Mr. Schneiderman said.

Flexible benefits makes sense for Chemical because of its recent acquisitions, he added.

"A flexible benefit plan allows us to assume subsidiaries much more easily," Mr. Schneiderman said. The structure of a flexible benefit plan enables companies that merge to bridge their historic benefit structures more easily.

But some employers are concerned about the legislation.

"The regulations have been changed to let a company be at tremendous risk," said Ben Crawford, vice president of human resources at General Time, a clock manufacturing company in Atlanta.

The company, which has not yet told its employees of the new regulations, plans to reduce the maximum that an employee can contribute to $1,500 from $5,000.

General Time, which kicked off its flexible benefit plan in January, has 750 employees.

"We had already gotten sensitive to the fact that a benefit plan that's designed for the average person does not work," Mr. Crawford said.

"Our objectives at the beginning were to provide better coverage — to provide choices, some control over their benefits. But as we got into it, we realized we could save substantial money for the company by not providing everyone with the same benefits."

At Valero Energy Corp., San Antonio, Texas, a flexible benefit program has allowed the company to harness its medical costs, said Bob Taylor, director of compensation. "It kept our medical expenses from rising for about three to four years," he said. Mr. Taylor implemented the plan for the company's 2,000 employees in June 1984.

Employee benefit consultants say that next to meeting employee needs, containing health costs is the primary objective in implementing flexible benefit plans.

"The impetus for growth in flex is the continued increase in medical care costs," said Mr. Taggart of Mercer Meidinger.

According to a 1988 survey conducted by Foster Higgins of 793 companies with 1,000 or more employees, 35% adopted flex plans to meet the diverse needs of their employees and 33% installed plans to contain health costs.

Flex plan sponsors spent $2,280 per employee in total health care costs in 1988. Traditional plan sponsors spent 9% more. ■

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Suppliers targeted

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company hammered out with 150 different hospitals saved $3 million to $5 million between mid-1988 and mid-1989, the first full year they were in effect.

But the biggest recent development in cost containment is a new form of managed care known as the open-ended HMO or the point-of-service network, which is a cross between an HMO and a PPO.

The basic premise is that doctors and hospitals in these networks have strong financial incentives to provide cost-efficient care. Doctors might be given per-patient budgets, for example, or get bonuses if claim costs meet pre-set targets. If they don't meet their cost control targets, they are penalized through payment reductions.

Employees don't have to use these networks, but are reimbursed at much lower rates if they go to non-network providers. Each time they enter the network, they go to a primary care physician or "gatekeeper," who orchestrates their care and determines if expensive speciality services are needed. The insurers or managed care firms who run these networks often have profit- or loss- sharing arrangements with companies and hence are especially motivated to control cost.

Southwestern Bell Corp., St. Louis, was one of the first companies to go this route. Since it began in July 1987, the company's point-of-service network has been expanded to cover 13 cities and 65% of its active workers and retirees. The only network expense for employees is a $5 office visit charge. But if they go outside the network, they pay a $300 individual deductible and 20% of all charges.

Results so far are impressive. Southwestern Bell's medical costs rose by roughly 12% last year, compared with an average annual increase of 20% in the early 1980s and 30% for companies in general last year. In 1989, it expects an increase in "the single digit range for the first time in many, many years," said Craig Campbell, associate director of benefit planning.

Other companies using point-of-service networks include Allied-Signal Inc., Procter & Gamble Co. and First Interstate Bank of California.

The list of companies that have either gone or plan to go this route "reads like a Who's Who directory," noted Mr. Leisure of TPF&C.

Of course, these networks have their downside. In trying to meet their cost control targets, providers may tend to undertreat patients. It's also hard to hold down utilization levels, in part because network expenses for employees are typically set at negligible levels in order to draw them into the cost-efficient network environment. Some networks have had unsatisfactory cost results for this reason.

But as Steven Shulman, a principal at Value Health, Avon, Conn., a firm which principally manages network of providers, pointed out, undertreatment and utilization problems can be avoided if network providers are carefully selected and continuously monitored. And since people are free to leave the network whenever they wish, point-of-service systems have "an internal check and balance on the quality of care as perceived by employees," said Mr. Shulman.

Yet another strategy being tested involves focusing special cost containment efforts on certain benefits whose costs have been rising especially quickly — most notably, prescription drug and mental health and substance abuse benefits.

A network of providers, often of the point-of-service variety, is set up to deliver these carved-out benefits.

Chevron, for example, was dissatisfied with the cost and quality of the mental health and substance abuse care its employees were getting, so it carved these benefits out of its indemnity plan and HMO contracts at the beginning of this year. A new point-of-service network run by American PsychManagement is providing these benefits at a per-participant cost that's about 20% lower than under the old arrangements, even though the quality of care is better and more people are using it. "We are more efficiently providing that care," says Chevron's Mr. Ross.

In July, the company also opened a pilot point-of-service network covering all benefits (except mental health and substance abuse) for its employees in the Houston area.

Looking ahead, companies eventually will benefit from new medical or patient outcomes research, which tries to set guidelines for appropriate care by determining which procedures, medicines and methodologies work best in treating various conditions. This work is vital to cost containment since it is estimated that up to 25% of all procedures performed are unnecessary.

Some network managers are beginning to disseminate this research to the providers in their systems to help them more efficiently manage cases. And once accepted guidelines are developed, insurers and even employers will be able to use them in selecting providers they wish to deal with and in questioning payment for inappropriate care.

Will these new approaches as a whole succeed in containing medical benefit cost increases over the long-run? No one claims they are the ultimate answer. And even if they do wring a lot of the inflation out of the health care system, the underlying inflation trend line still has a steep upward slope, thanks to the ongoing development of expensive new technology.

But even so, many people have high hope for managed care vehicles such as HMOs, PPOs and especially point-of-service networks, because they transform providers from adversaries into partners in the cost control process.

"We have the tools," concludes Value Health's Mr. Shulman, "Now we just have to learn how to fine tune them." ■

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FINANCING

UPDATE

Cash flow declining

Corporate free cash flow is expected to decline in 1989, Merrill Lynch Capital Markets predicts.

Free cash flow and the financing gap both measure the difference between corporate cash flow and capital spending. Free cash flow is based on Standard & Poor's Corp. per share values; the Federal Reserve calculates the financing gap on the basis of GNP data.

The two measures tend to move together. But in 1987, they diverged, according to a recent report from Merrill's global securities research and economic group. Free cash flow jumped from a negative to a positive value, and the financing gap widened.

The financing gap became more negative in 1988 and the first half of 1989. Free cash flow remained positive last year, Merrill Lynch thinks it will drop for the full year.

Gains from asset sales appear to account for the difference between free cash flow and the financing gap. Such gains are part of earnings per share but are excluded from GNP measures of profits.

Merrill believes corporate earnings momentum is fading. Despite continued economic growth, the report said profit margins are being squeezed, and corporate profits are declining.

The report said asset sales may have boosted earning per share as much as $3.50 in 1988, up substantially from levels in previous years. But write-offs reduced earnings per share by $1.72 last year, by 92 cents in 1987 and by $2.41 in 1986. Asset sales appear to have increased earnings in 1987

Continued on page 58

A&W Brands bubbling with possibilities

Interest among institutional investors for other soft drink companies goes flat

By Marcia Parker

WHITE PLAINS, N.Y. — Up against giants of the soft drink business like PepsiCo Inc. and Coca-Cola Co., little A&W Brands Inc. has a big challenge ahead.

Not only is competition fierce, but the industry is experiencing a slowdown in soft drink volume growth, and investor interest seems to be ebbing in the stocks.

Soft drink holdings by institutions peaked at midyear. As of June 30 — just prior to the reversal of favorable relative performance trends — the institutional holdings of all major soft drink equities reached record levels, according to Kidder, Peabody & Co. In addition, soft drink stocks generally are viewed as overvalued by many analysts and investors right now.

Although many of the beverage industry leaders aren't getting buy recommendations from Wall Street, A&W continues to have a strong following among analysts and investors. Zack's Investment Research, Chicago, says it is recommended by three analysts.

Hicks & Haas is the Dallas buyout firm that bought A&W from a private investor group in May 1986 from a private investor group for $70.2 million. Its partners have split, but the original partnership still owns 11% of A&W. United Brands owns 7.8%, and has said it may sell its stake.

As of June 30, A&W was 56% owned by institutional investors, according to CDA Investment Technologies Inc.'s Spectrum survey. Among the largest of these investors are Aetna Life & Casualty Co., Fred Alger Management Inc., the California State Teachers' Retirement System, Jennison Associates Capital Corp., Putnam Management Co., TCW Asset Management Co. and Wells Fargo Bank.

Ginger Risco, analyst, Fred Alger Management, New York, said the company has a "great business. They sell, concentrate, have very little overhead and very good cash flow. The have done an excellent job with their brands. They have a fantastic niche."

The soft drink company that is best known for its A&W Root Beer is focusing on how to outmarket its rivals, scouting for acquisitions and studying options for investing its substantial excess cash flow.

"We're at a crossroads of finding a meaningful use of our cash flow," M.L. Lowenkron, A&W's president and chief executive officer, said in an interview.

A&W just paid off its senior debt — in less than two years — and has a large untapped credit line from Chase Manhattan Bank. It's an enviable position for a company to be in at a time when leverage is a bad word in corporate America.

Mr. Lowenkron said the company is considering several options.

"We can acquire companies that have synergies with A&W and stay in the business we know well — and we're prepared to do that — or move into another growth area," he said.

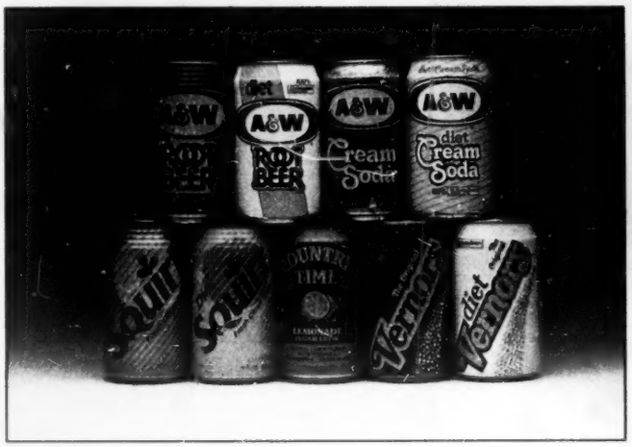
"There are also expansion opportunities in the (United States) with Squirt, Vernors and A&W Cream Soda, and international opportunities that we can accelerate in Central, South and Latin America; the Far East; Japan; and other countries."

Also being examined is the possibility of a recapitalization or offering a substantial dividend to shareholders. Another is to borrow money at today's reasonably low rates and pay down higher interest rate debt. The 1990 company strategic plan should be presented at the board of director's December meeting, Mr. Lowenkron said.

For the year ended Dec. 31, 1988, A&W had $102.4 million in sales and $7.5 million in net income. The 1989 second quarter was the largest sales quarter in the company's history; net earnings were up 42% and operating cash flow increased 29%. Third quarter results, which are expected to be even better, will be released this week. A&W expects 1989 operating profits to show record sales and improved earnings and operating cash flow this year compared with 1988.

A niche player in an industry dominated by giants with loyal consumer followings and sales and revenues that far surpass its own, A&W markets nine soft

Continued on page 60



A&W Brands, having repaid its senior debt, has positioned itself to take on some of its larger competitors in the soft drink industry.

Total investment banking fees paid

Amount	Total companies	Total industrials	Large industrials	Total utilities	Bank holding companies	Thrift institutions
None	10%	5%	2%	7%	10%	20%
Under $100,000	11	8	5	11	21	12
$100,000 - 200,000	9	7	5	9	13	10
$200,001 - 300,000	5	5	3	2	6	6
$300,001 - 400,000	2	1	*	2	5	3
$400,001 - 500,000	4	4	4	3	4	6
$500,001 - 600,000	3	4	4	5	1	5
$600,001 - 700,000	1	1	1	1	2	2
$700,001 - 800,000	2	1	1	3	2	1
$800,001 - 900,000	1	*	0	1	0	0
$900,001 - 1 million	3	3	3	6	1	2
$1.01 - 2 million	10	10	13	15	11	8
$2.01 - 3 million	5	5	6	6	3	4
$3.01 - 5 million	6	8	12	7	6	5
$5.01 - 10 million	6	8	11	4	7	1
$10.01 - 15 million	3	4	3	3	1	1
Over $15 million	4	6	8	3	2	2
No answer/uncertain	16	17	16	12	7	14
	$ thousands					
Mean (including none)	$3,956	$5,565	$7,349	$2,348	$1,783	$1,138
Median (including none)	550	1,500	1,500	950	250	250
Mean (excluding none)	4,488	5,951	7,553	2,540	1,963	1,478
Median (excluding none)	950	1,500	2,500	950	950	450

* less than 1%
Source: Greenwich Associates, Greenwich, Conn.

Corporations are paying higher investment banking fees

GREENWICH, Conn. — Total investment banking fees paid by the typical industrial corporation averaged $5.6 billion during the year ended Aug. 31, up 28% from last year, Greenwich Associates reports.

Pronounced gains occurred among Fortune 400 and 500 industrials, whereas fees paid by the 300 largest industrials increased by only 8% to $7.3 million.

On average, industrial corporations paid merger and acquisition fees of $2.7 million during the past year, up by nearly 60% from last year.

Increases with Fortune 400 and 500 companies account for much of the rise, since M&A fees paid by the 300 largest industrials were up by 25% to $3 million. In aggregate, each company pays one half or more of total fees to a single investment bank.

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September 1989

Poland set to embrace ESOPs

By Leonard J. Hollie

Although employee stock ownership plans have been very popular in Western Europe, particularly the United Kingdom, Eastern Europe has largely ignored the concept.

Now however, Poland, which recently named its first non-Communist government since World War II, is poised to install ESOPs in a variety of industries as a means of privatizing its government-dominated economy.

"ESOPs have proven to be an effective means of corporate acquisition in the (United States). Why not use them to acquire state-owned enterprises in socialist countries?" queried Leon Irish, a partner with Jones, Day, Reavis & Pogue, Washington, during a recent conference on global ESOPs. Mr. Irish specializes in employee benefits and international law.

"The idea of ESOPs is popular in Poland because it is seen as a tool to wrest control of the economy from the state," he said.

Mr. Irish and other observers said it seems ESOPs could fit well with the political theories of both capitalist and socialist countries.

"In socialist countries, ESOPs could put the means of production in the hands of the workers, a major tenet of Marxism," said Mr. Irish. "There is also the theme of social justice in socialist countries."

"ESOPs have a great future in socialist countries; the first two ESOPs were formed in Russia" before World War I, said James Zukin, a principal of Houlihan, Lokey, Howard & Zukin Capital, Los Angeles. Mr. Zukin has been involved in many of the major ESOP leveraged buy-outs in recent years.

In Poland and other Eastern European countries, there are both problems and opportunities for Western investors.

Poland, a country with 27 million people, has an overwhelming debt, owing $40 billion to foreign debtors, including the Soviet Union. Some 94% of Poland's economy is owned by the government; the rest is in private hands.

"We have seen, and the communist countries are now finding out, that state ownership does not work in socialist countries," said Mr. Irish. "It's inefficient and it's impossible to set market prices centrally. You also can't tell if a profit is being made in a state-owned enterprise."

"We had a customer who wanted to put together a deal in Poland, but he couldn't find any of the company's financial statements," said Mr. Zukin.

And there are other problems in Poland for Western investors: The industrial base is sub-standard; there is no convertible currency; there is no banking system as it is known in the West; the country is politically unstable; and there is a language barrier.

However, with an infusion of U.S. government aid, money from international organizations and the political opportunity in Poland to restructure the economy, U.S. investors seem at least willing to investigate investment opportunities. Lucy Swiatkowski, a consultant with the World Bank, said scores of consultants from American companies are pouring into Poland. This interest was spurred in part by the new Polish political order and economic exigencies.

But the interest among American consultants also is being fueled by a Congressional bill that would give $100 million to Poland to support a Polish-American Enterprise Fund. The bill also seeks $25 million for a Hungarian-American Enterprise Fund for Hungary, which selected a non-Communist government for the first time in more than 40 years earlier this month. Named the "Poland and Hungary Democracy Act of 1989," the bill is designed to promote democracy and reform in those two countries through development of the private sectors, labor market reforms and environmental protection, among other changes.

That amount does not include the $1.4 billion in aid promised by President Bush over the next two years to both countries. And, the International Monetary Fund and the World Bank will invest about $300 million in both countries each year, for two years, Mr. Irish said.

"Polish Solidarity leaders feel they have a certain amount of time to prove to themselves, Polish workers and foreign investors that the economy can be saved," said Ms. Swiatkowski. "They feel that ESOPs must be in place by next year to keep the Communists from wanting to regain control of the economy."

Though it is too early to assess the needs of the Hungarian economy and how they would use the ESOP concept, Ms. Swiatkowski said the Polish economy had needs in several areas: foreign investors' economic expertise to run the companies; convertible capital; and in making companies competitive on the world market and to operate independently of the Communist government.

Ms. Swiatkowski said under the ESOP plan Solidarity is considering, several key enterprises would remained state-owned, but most would be transferred to employee ownership or to joint ownership between ESOP and the state or an ESOP and a foreign investor. ■

Turnover issues get a hearing

By Joel Chernoff

WASHINGTON — Pressures are building on Capitol Hill to use the tax system to discourage short-term turnover of stocks, but pension fund executives believe legislators and business executives are blaming the victim of recent changes in the market structure.

While some speakers before an Oct. 2 hearing of the Senate Banking Committee's securities subcommittee favored imposition of a tax on short-term gains by pension funds to discourage short-term investment behavior, others said such a tax would be harmful, suggesting either a transfer tax or no tax at all.

The tone of the hearing reflected a new perspective in dealing with the tensions between corporate management and institutional investors. Instead of the traditional focus on "corporate accountability," experts now are discussing "the responsibilities of share ownership," said Sen. Christopher Dodd, D-Conn., who chairs the subcommittee.

Sen. Dodd later said, however, he did not have any ready responses of how to deal with this issue. "I certainly do not have any preconceived notion of legislation in this area."

Nevertheless, others clearly favored imposition of a tax on short-term gains.

Sen. Nancy Kassebaum, R-Kan., who has proposed legislation that would create such a tax, said that even if only 20% of institutional investors are turning over their stock portfolios at annual rates of 100% or more, that is "too much," and is "not healthy for our economy."

A background report prepared for the panel revealed that some money managers have annual turnover rates as high as 400%.

Selected stock managers with high portfolio turnover
(Year ended June 30)

Firm	Number of stocks	Size of portfolio ($ millions)	% turnover
Westridge Capital*	10	86	398.7
Dean Witter	30	24	365.1
Spear, Leeds & Kellogg	120	64	332.1
Merrill Lynch	91	58	313.6
PaineWebber	1,371	638	260.6
Alpine Associates	61	534	216.8
R. Meeder & Associates	107	51	216
Michael H. Steinhardt	219	1,715	164.3
Strong/Corneliuson	240	2,247	167.3
Heilman, Jordan	56	874	143.5

*Data for one quarter not available
Source: CDA Investment Technologies' Spectrum, Silver Spring, Md.

Andrew Sigler, chief executive officer of Champion International Corp., Stamford, Conn., who favored a short-term tax, told the Senate panel institutional investors are focusing on the short-term outlook to the detriment of business' ability to invest for the future. If companies don't produce earnings today, they risk being taken over and broken up, Mr. Sigler said.

Willingness of institutional investors to sell their shares when a company's near-term earnings potential might be marred by corporate investment has had "a very negative impact" and "will get worse," he said.

Instead, it is time to look at "the responsibilities of ownership," he said.

Mr. Sigler advocated taking a broader view on how institutional investments affect corporations, employees and others. Corporate America has to "own up to the fact that in many respects, we are our own worst enemy," Mr. Sigler said. He explained employees are dependent on their employers' continued existence so they can receive a pension upon retirement.

Mr. Sigler tried to deflect impressions that he is out to blame pension funds, saying instead changes in the system are responsible. "There are no bad guys," he said.

Robert G. Kirby, chairman of Capital Guardian Trust Co., Los Angeles, said some kind of graduated capital gains tax, including a short-term tax on tax-exempt investors, would help convert institutions to investors from speculators. "Every company can be put in play under the present rules, and there's no way to stop it."

New York State Comptroller Edward V. Regan, sole trustee for the $41 billion New York State & Local Retirement Systems, Albany, opposed taxing pension funds on short-term gains.

Rather, he prefers a transfer tax of one-half of one percent of transaction size, for example, on all stock purchases and sales as a means to discourage high turnover.

Sen. Kassebaum, however, said a securities transfer tax had gone over "like a lead balloon" before the Senate Finance Committee.

Connecticut State Treasurer Francisco L. Borges, who oversees the state's $8 billion pension fund, opposed any type of taxation, arguing that most pension funds invest for the long haul, citing Connecticut's 11% annual turnover rate.

Instead, he argued attention should be focused on "the buccaneers of the system" — Wall Street bankers, speculators and corporate managers. "In large measure, we are punishing the victims," Mr. Borges said. "We are not the individuals who are initiating these transactions." ■

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ADRs

Continued from page 1

merchant banking firm of SG Warburg, New York.

"The difficulty people have in putting together junk bond financing (for acquisitions) is going to help" ADR financings, he said. "It is more probable and possible to put together these deals now."

Mr. Keevil agreed that although there hasn't been a large-scale movement toward the use of ADR financed acquisitions, "the opportunity is better now, particularly where all-cash transactions may be more dilutive. Many European companies want to broaden their (stock) ownership, and will look to using their stock for (U.S. acquisitions) There is greater interest now, and we will likely see several more of these type of deals in the next couple of years."

Joseph Velli, director of ADRs at Bank of New York, said he doesn't expect to see a landslide of deals using the receipts. "Cash is still king. I expect to see three to five of these transactions each year. We'll see them where there's a friendly deal or where it's a supplement to a cash payment," he said.

Investor interest also is driving the growing use of ADRs. Institutional investors are big buyers of ADRs, as they move rapidly into global investments. The top 10 holders own more than $4.7 billion of ADRs, according to Carter Valin Pollen, the investor relations division of the Carter Organization Inc., New York, which conducts stock surveillance and investor relations for companies with ADR programs.

The institutions are: CIGNA Corp., with $980 million; Delaware Management Co., with $738 million, FMR Corp., $522 million; Manufacturers National Corp., $501 million; Capital Guardian Trust Co., $501 million; Wellington Management Co., $386 million; the California Public Employees' Retirement System, $369 million; INVESCO Capital Management, $239 million, Alliance Capital Management L.P., $232 million; and IDS Financial Corp., $227 million.

John Seiter, senior vice president of Capital Guardian, said the firm views ADRs "very positively. We consider them an effective alternative in a non-U.S. equity portfolio where sometimes there is a greater advantage to owning ADRs than the underlying stock due to imbalances in the ADR and the underlying stock prices. We encourage our equity clients to allow us to use ADRs." He said ADRs also are used sometimes in domestic equity accounts when authorized.

"If we have the flexibility to buy a world-class company, we will do so where we can," Mr. Seiter said.

Observers point to the use of ADRs as a way to finance acquisitions with minimal time delays and fewer regulatory drawbacks than using foreign stocks. That's because ADRs are registered with the Securities and Exchange Commission and represent title to a specified number of foreign shares. There are currently about 800 ADR programs in U.S. markets, but fewer than half of those companies are actively traded and considered liquid enough to be of significant interest to institutional investors.

Foreign investor interest in U.S. markets has been amply demonstrated in recent years. According to the Securities Industry Association, New York, foreign investors held nearly $200 billion in U.S. equities at the end of 1988. Direct foreign investment in U.S. companies through acquisitions has been on the upswing, and the unification of the European markets in 1992 could stimulate additional use of ADRs as a vehicle to raise capital and in the merger and acquisition arena.

Besides the Kyocera/AVX deals, there have been several other mergers or acquisitions financed with ADRs. For example, Akzo N.V., a Dutch chemical company, used 3.1 million ADRs to help finance its purchase of Reliance Universal Inc., Louisville, Ky., a unit of Tyler Corp., Dallas, in a stock-for-stock transaction. (*Pensions & Investment Age*, June 12).

"ADRs can be a very useful instrument in mergers and acquisitions, but we haven't seen a wave of them yet. But the general consensus in the ADR industry is that there are likely to be some more of these types of deals in some fashion," said Robert C. Hubbell, executive vice president of Carter Valin Pollen.

Mr. Hubbell said ADR mergers or acquisitions probably will be confined to friendly deals, such as the Kyocera stock swap.

ADRs also are used to sweeten acquisitions using cash. When British Petroleum agreed to purchase the remaining shares of Standard Oil of Ohio that it didn't already own for $7.5 billion in 1987, it "tacked on a warrant to allow Standard shareholders to purchase BP ADRs to sweeten the deal," Mr. Hubbell said.

Standard Oil stockholders received BP shares and a warrant for one British Petroleum ADR for each Standard Oil share they owned.

Stock options, he said, make such deals more attractive to U.S. employees of foreign subsidiaries because ADRs are more liquid than the underlying shares of a foreign company.

While ADR transactions are less complicated, their use requires extensive SEC reporting and may be slower than using cash. But for cash-strapped companies or companies not wanting to take on a heavy debt burden, the ADR transaction might be the best alternative.

The use of ADRs helps foreign companies "avoid using up cash or borrowing capabilities and allows them to trade on the fact that they have a good securities market at home," said Edward Davis, attorney and partner at the firm of Hughes Hubbard & Reed, New York, which helped facilitate foreign acquisitions using ADRs.

Last year Attwoods PLC, a British waste management firm and one of Mr. Davis' clients, acquired Eastern Waste Industries using ADRs.

A year before the acquisition, he said, Attwoods ADRs were registered with the SEC and began trading on the NASDAQ, "which gave them a high degree of prominence and visibility."

Mr. Davis said ADR-financed acquisitions "frequently" can be structured to avoid capital gains taxes until the shares are sold, thus providing a tax advantage to such deals.

Mr. Davis said acquisitions using ADRs simplify the process for foreign companies interested in U.S. companies.

"If you use your own stock, it is much more difficult because of the regulatory process in the SEC and the (stock) exchanges. It is an abbreviated process for companies to come in here and use registered ADRs," he said.

While it may be too early to call ADR acquisitions a trend, Mr. Davis said the trend is coming.

He said there is "strong interest" by foreign companies in buying U.S.-based companies because "this is an existing, unified market, and they want to have the ability to sell a single product in Texas and in New York." ■

Florida

Continued from page 2

issues as the annual contribution required to fund a particular defined benefit plan.

One of the committee's primary considerations was concern that public harm might result from the involvement of non-legal professionals in the pension area, Ms. Bateman said. "Our legal opinion was that there were certain areas that non-lawyers needed to be involved in and there were areas that lawyers should be involved in," she said. "It's really a legal question — 'Is it the unlicensed practice of law?' "

In its opinion, The Florida Bar states the proposed guidelines would serve the public interest by restricting non-legal professionals, who lack the legal expertise to evaluate the tax implications of a pension plan on other areas of a company's operations, such as estate tax or probate planning.

In addition, the public would be protected from professionals who are not bound by the legal ethic that is part of the attorney-client relationship. Some professionals might be motivated by the sale of the product rather than by the plan itself, the opinion stated.

Briefs filed in response to the opinion protest what actuaries, employee benefits consultants and accountants nationwide view as an unreasonable attempt to usurp their responsibilities and, at the same time, deny employers of qualified services.

"That's all it was — a test of the self-interest of the members of the Florida Bar in their attempt to stake out an actuarial role for themselves only," said Richard Raskin, a consulting actuary with The Wyatt Co., New York.

Wyatt didn't file a brief, but helped draft the brief filed by the Association of Private Pension and Welfare Plans, a Washington lobbying group.

Mr. Raskin said Wyatt officials felt APPWP's brief, which included seven affidavits signed by pension executives, would be more effective because it represented the interests of employers.

Officials of Florida Power & Light Co., Miami, whose plan covers 15,000 employees, and United Telecommunications, Inc., Kansas City, Mo., whose plan covers 39,000 employees, were among those filing affidavits.

The APPWP brief contends the Florida Bar opinion should not be permitted because the Employee Retirement Income Security Act preempts all state laws regulating employee benefit plans. In addition, the new guidelines are not in the interest of employers.

"The cost of doing many functions that are done now by people not attorneys would go up a great deal because every time you did something, you would have to bring in an attorney," Mr. Raskin said.

Mr. Raskin and other actuaries said although many of the services they provide are done in conjunction with in-house legal professionals or attorneys they recommend, such current practices would not be allowed under the proposed guidelines.

"To say that only attorneys should be able to draft summary plan descriptions is going further than I expected," said Jan Alan Chorvat, principal at William M. Mercer Meidinger Hansen Inc., Tampa. Mercer Meidinger Hansen filed a brief in conjunction with TPF&C's Atlanta office, another firm with an extensive employee benefits practice. ■

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TAA growth slows

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bonds, 30% stocks and 15% cash.

Avatar had $1.8 billion in tactical asset allocation accounts, up 38.5% from the previous year. The firm has gained 10 clients during that period for a total of 104.

At The Boston Co. Inc., Boston, the current asset allocation also reflects a conservative approach to the stock market's performance, said Ed Peters, manager of asset allocation and structured investment products.

"The stock market has just hit an all-time high, and people are starting to get nervous," Mr. Peters said. Currently, the allocation of the overlay portfolio, one of the firm's four TAA investment styles, is 25% stocks, 33% bonds and 42% cash.

The firm reported $3 billion in TAA assets, up 42.9% from a year earlier. Its roster of clients grew to 38 from 25 during the period.

The current TAA allocation at Mellon Capital Management Corp., San Francisco, a 15-year veteran of TAA strategies, is more aggressive than that of some other firms, said Tom Loeb, president and chief executive officer. "We have tended to be more in equities than in bonds or cash this year," he said. Until recently, Mellon allocated 50% of its assets to equities and 50% to long-term bonds, but now has moved a small portion of its assets to cash.

Mellon Capital had $7.1 billion invested in TAA products, up 29% from a year earlier. Mellon increased its roster of TAA clients to 61 from 48 during this period.

Samson Wang, president of Beacon Capital Management, New York, does not share other managers' cautious approach. "I'm very bullish," he said. Beacon is fully invested in equities and has been since the presidential election. And what are Mr. Wang's expectations for the market? "New highs," he said.

Beacon had $1 billion under management in TAA strategies, a 25% increase from a year earlier.

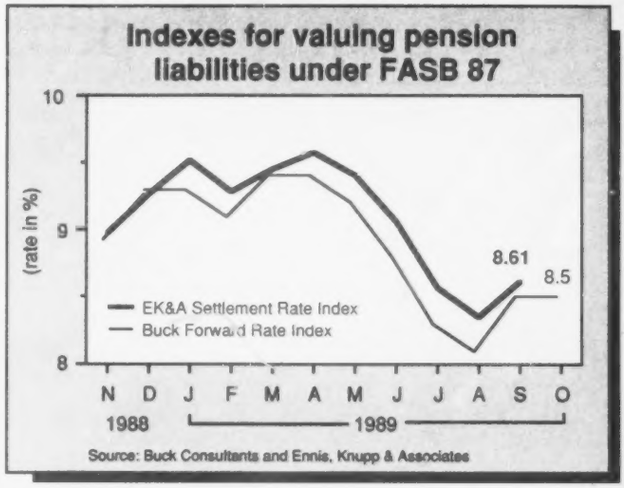
Despite its lack of exposure to the equity market, J.P. Morgan Investment Management Inc., New York, still reported the greatest growth among the managers surveyed, with a 272% increase in TAA assets to $2.148 billion. The roster of clients grew to 18 from 5.

Morgan's fixed-income product, referred to as its tactical duration model, reallocates among cash, bonds and notes and was overweighted in long-term bonds in time for the June rally, said Maxine Maly Stomber, an assistant vice president.

"That helped us a great deal, and obviously it hurt the cash people quite a bit," she said.

Prudential Diversified Investment Strategies, an affiliate of the Prudential Insurance Co. of America, Newark, N.J., had $7.2 billion in TAA strategies, an increase of 9.1% from the previous year. PDI lost six TAA clients in the past year, reporting a total of 75 this year.

First Quadrant Corp., Pasadena, Calif., had $4 billion in TAA accounts, up 122.2% from the previous year. The firm added six clients, bringing the total to seven. ■



Fund jumps

Continued from page 1

then about $12 billion, would be indexed, since studies had shown that 75% of the active equity managers couldn't beat indexed stocks.

She left before her system was completely installed, and the question of whether active stock investment could beat passive investment for such a large portfolio was left undecided.

With Basil Schwann selected as the acting chief investment officer, the staff and Wilshire Associates began planning the next moves. Wilshire consultants recommended the move to indexing, said Mr. Bowman, who was then the chief investment officer for the City & County of San Francisco Retirement System.

Given the changes in personnel and the current personnel makeup, indexing of the equity assets best complemented the pension fund's current thinking and resources, said Mr. Nesbitt.

"The prior strategy was a reflection of the prior chief investment officer, and with the change, I think this current strategy is something that better reflects this chief investment officer and (the strategy) will endure for quite some time," said Mr. Nesbitt.

Prior to Mr. Bowman's hiring, he was asked for his opinion on the planned move into indexing for domestic equity assets, and he endorsed the idea, he said. He pointed out the fund's equity investment is so large it already closely reflects the market, and a passive strategy helps keep the system's management cost low.

Late last year, the retirement board approved the move into indexing, and when Mr. Bowman became chief investment officer in February 1989, talks were held with nine of the largest brokerage houses in New York to discuss trading procedures that would keep costs down.

"The shift (to indexing) doesn't necessarily create a great deal of transaction costs," Mr. Nesbitt said. "This is a strategy change that is being implemented at a very reasonable cost."

No money is being moved away from the system's external equity managers, which are Atalanta/Sosnoff Capital Corp., New York; Batterymarch Financial Management, Boston; Chancellor Capital Management, New York; Dimensional Fund Advisors Inc., Santa Monica, Calif.; Brinson Partners Inc., Chicago (formerly First Chicago Investment Advisors); Lazard Freres Asset Management, New York; RCM Capital Management, San Francisco; Roll and Ross Asset Management Corp., Blue Bell, Pa.; and TSA Capital Management, Los Angeles.

The contracts of all nine managers are coming up for renewal, however, and the retirement system board could make a change based on different needs in active equity management because of the indexed assets.

Mr. Bowman would not say in what direction the pension fund might want to go with its active equity strategy. External equity managers won't manage more than about $1 billion each for the system, he said, because officials for the system doubt a manager can beat the market with too large a portfolio. The outside managers, he said, will play an important role in diversifying the system's domestic equity strategy.

In the future, said Mr. Bowman, the retirement system might want to add index funds tilted toward various sectors of the market. But for now, he said, the plan is to track the S&P 500 and the Wilshire 2500. ■

Big draw

Continued from page 2

terSec. Funding accelerated quarter by quarter, he said. "As far as we can see, during the third quarter, it's more of the same," he said.

The argument for international investing remains the same as ever — that its diversification effect will enhance long-term returns, he said. Public funds are doing much of the international manager hiring now because they previously had not gone into this asset class to the same degree as corporate funds, he added.

In both international and domestic stock and bond hirings, active strategies continued to outpace of index funds. But while "plain vanilla" indexing may have topped out, specialized indexed strategies are still attracting interest.

For instance, in the domestic stock area, Westridge Capital Management Inc., Los Angeles, attracted $88 million for an indexed account enhanced with futures and options for the $1.05 billion K mart Corp. defined benefit plan, Troy, Mich. Westridge replaced Stein Roe & Farnham Inc., Chicago, which discontinued this strategy.

Another $15 million went to a small-capitalization stock index fund managed by R. Meeder & Associates Inc., Dublin, Ohio, for the $282 million Ohio State University endowment fund, Columbus, which put a total of $65 million into index funds.

External management of GICs picked up steam with $555 million assigned to this area. Trust Advisory Group, Westport, Conn., landed the biggest account here when it was assigned as adviser to a $450 million GIC fund at Westport Bank & Trust Co. PRIMCO Capital Management Inc., Louisville, Ky., is subadviser on the account. PRIMCO, Bankers Trust Co. — Investment Management Group, New York, and IDS Trust, Minneapolis, won other managed GIC accounts in the quarter.

Two accounts that defy classification also constituted big asset moves in the quarter.

The $225 million Kansas City (Mo.) Public School Retirement System assigned Weiss, Peck & Greer, New York, $108 million on top of the $25 million the firm already ran in a balanced account for the system.

Asset classes for the new money were yet to be determined; the firm was chosen as the system's "master manager," with assignments to coordinate assets and liabilities and to have input on assets run by the fund's other investment managers.

Also, Milliken & Co., Spartanburg, S.C., assigned $300 million to T. Rowe Price Associates Inc., Baltimore, with asset classes undisclosed.

Other hirings reported in the quarter were $194.4 million for balanced accounts, $95 million for real estate and $10 million for venture capital. ■

Market repays

Continued from page 2

assets out of equities was the fourth quarter of 1987, the quarter in which the market crashed.

To reduce exposure in equities, there has been a net purchase of other types of investments, primarily real estate and foreign equities, according to Messrs. Stevens and Wolfe.

Figures from the SEI Funds Evaluation Services universe of 2,000 balanced accounts show those portfolios increased their equity commitments to 49.3% as of June 30, from the low of 46.5% as of Dec. 31, 1987. But this was still far below the peak of 53.9% June 30, 1987. "I think people are still uncomfortable with the equity market," said William Madden, senior vice president at SEI.

Among the pension funds that haven't increased their equity allocation since the crash is K mart Corp., Troy, Mich., with $1.5 billion in assets. William F. Camp, assistant investment manager, said K mart's managers pulled out of equities before the crash and have not done much in equities since. "That's hurt us," Mr. Camp said. K mart has a 55% equity allocation, vs. 51% in January, with the increase being due largely to the market's rise.

Discouraged with the equity market, some pension funds turned to fixed income. The SEI universe of balanced accounts show that on Sept. 30, 1987, bond allocation was 31.9%. By June 30, 1989, bonds comprised 36.5% of balanced accounts.

GTE Corp., Stamford, Conn., moved $1 billion to bonds, lowering its equity allocation from a high of 71% in September 1987 to 68% as of June 1989, said Richard Pegnataro, director-operations for the pension fund. "Our trend has been to lessen equity allocation since the stock market crash," he said.

But some consultants said they haven't seen a movement into bonds.

"We thought following the crash that there would be substantial reductions in equity allocations, but people have kept their same levels of allocation," said Roger Bransford, national director of asset consulting for TPF&C, Atlanta. "Most people understand that over time, it is wise to remain pretty heavily invested in equities."

Ronald A. Karp, president of Ronald A. Karp Associates, Summit, N.J., said the equity positions of his clients — between 45% and 60% — are not much different now than before or right after the crash. "With one minor exception, they didn't make a decision to increase or decrease, and they haven't done anything recently."

John R. Smith, manager of pension plan coordination for Procter & Gamble Co., Cincinnati, said the $170 million defined benefit fund's position hasn't changed dramatically since the crash.

The pension fund's equity exposure was lightened a little prior to the crash when some of the fund's money managers said they thought the market was overpriced, and they moved some money into cash, Mr. Smith said.

The equity position of the Procter & Gamble fund is around 55%. "We regarded the crash as an aberration, and we weren't panicked by it," he said.

Mr. Smith believes most fund managers stayed with their long-term strategies and did not reduce equity allocations. "I don't know of anyone jumping out," he said. "Anyone who has a plan is in there for the long term. I don't think they're going to run for cover." ■

European fund

Continued from page 3

pared with the typical 9-1 debt-equity ratio among U.S. deals, said Mr. Cohen.

Mr. Cohen said he is hoping for compound annual returns of 30% or more over the 10-year life of the fund — a target he considers realistic because "we have achieved that rate of return or better on buy-ins in existing venture funds." He would not reveal total performance figures of Patricof venture capital funds.

Of course, MMG Patricof's buy-in strategy could stumble if new management fails to revitalize companies — or if the local economies cool off. Fund officials "are planning as if there will be an economic downturn" in the United Kingdom, Mr. Cohen said. "People are saying it could happen within the next couple of years."

The fund's buy-in team includes three directors each in the London and Paris offices with backgrounds in strategic consulting, finance and general operations.

David Storrs, senior vice president of the Common Fund, said of the buy-in concept: "It's a solid investment strategy because the fund's goal is to build up, rather than break up, a company. A lot of (leveraged buy-outs) you see now try to cash out assets of a company, but we don't make any of those investments."

Another investor is PosTel Investment Management Ltd., London, the management company of the British Telecom and Post Office Pension Scheme. John Brakell, PosTel's manager of venture capital, said he was attracted to the buy-in fund's plans to bring in management. The Patricof fund is looking for underperforming companies where resources "are not being efficiently used," said Mr. Brakell. By bringing in its own managers — who will have "hands on experience for at least a year" before any replacements arrive — the Patricof fund should be better in control of its own deals than are some other buy-out funds, he said.

Paul Quirk, executive director of the Massachusetts PRIM fund, cited Patricof's "early" entrance into Europe's management buy-out arena. Pension funds entering the U.S. buy-out market at the beginning "made of lot of money," he said. ■